



## COMMISSION OF THE EUROPEAN COMMUNITIES

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### **REPORT FROM THE COMMISSION**

### **ANNUAL REPORT OF THE INSTRUMENT FOR STRUCTURAL POLICY FOR PRE-ACCESSION (ISPA) 2007**

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## **Introduction**

Following the Brussels European Council in June 2004, which awarded *candidate country* status to Croatia, this country has benefited from ISPA as of 1st January 2005. Croatia thus followed the previous ISPA beneficiary countries which received ISPA assistance from when the instrument was launched in 2000. On January 1st 2007 Bulgaria and Romania became members of the European Union and ceased being beneficiaries of pre-accession funding including ISPA. As a result, this report covers the ISPA activities carried out only in Croatia, being the single remaining recipient of ISPA financing. Reporting on the implementation of ISPA/Cohesion Fund projects in Romania and Bulgaria will be dealt with in the annual report for the Cohesion Fund.

ISPA as a programme ceased to exist at the end of 2006 and consequently no new projects will be approved. Therefore this and future annual ISPA reports will relate exclusively to the implementation of those ISPA projects in Croatia that have already been approved.

The year 2007 for Croatia entailed various challenges. The major goal was to make a start of tendering out the various contracts in order that disbursement of funds could commence. Progress in this respect was observed with a number of tenders being announced prior to the end of the year. Due to the fact that the respective tenders were launched only at the end of the year very little progress is apparent regarding the disbursement of funds.

Much attention was paid in 2007 to the transformation of the Implementing Agency from the Central Finance and Contracting Unit (CFCU - a body established within the structures of the Ministry of Finance) to the Central Finance and Contracting Agency (CFCA - a government agency). The change was necessary in order to enable the provision of more attractive financial and other incentives for the staff, to ensuring better staff retention and encouraging the engagement of additional suitably experienced staff. Both these actions were in response to recommendations made by the Commission's auditors in 2006.

## **ISPA budget**

In accordance with the Commission's activity based accounting system, the budget for the ISPA instrument was provided for by two budget lines: the functional budget line B13.01.04.02 and the operational budget line B13.05.01.01. The first line contains the means for covering Technical Assistance (TA) administrative expenses (mainly for reinforcing EC Delegations) and this ended in 2006, whereas the second line encompasses the payment appropriations made available for the effective implementation and operation of ISPA for the pre-accession countries of Croatia Bulgaria and Romania.

Budget line B13.05.01.01, amounting to €265,714,000 in 2007 (for Bulgaria, Romania and Croatia), covers all expenses for co-financing infrastructure projects (measures). Since both Romania and Bulgaria became Member States on 1<sup>st</sup> January 2007 the payments presented below from budget line B13.05.01.01 relate exclusively to Croatia.

**Table 1: ISPA budget in 2007 – in Euro**

<b>Budget line</b>	<b>Payments implemented</b>
<b>Functional budget line B13.01.04.02</b>	0
<b>Operational budget line B13.05.01.01 (Croatia only)</b>	124,629
<b>Total</b>	124,629

## Project funding

### 1. NEW ISPA PROJECTS

No new ISPA projects were adopted in 2007.

### 2. NEW COMMITMENTS

No new commitments were made in 2007 for projects either in the environment or transport sectors.

### 3. PROJECTS FUNDED BETWEEN 2005-2007

Between 2005 and 2007, the Commission approved a total of 6 projects on the basis of proposals submitted by Croatia. Of these projects, 3 concern the environment sector, 2 the transport sector, and 1 horizontal TA measure (for the organisation of the statutory monitoring committees and supporting ISPA implementing agencies). The total eligible investment cost of these projects is €123.052 million, with a total of €59 million, or 47.9%, being allocated as ISPA grants. A further €1 million was allocated to cover the costs of the administering of the ISPA programme by the Commission thereby allocating the entire €60 million of ISPA funds allocated to Croatia until the end of the programme. By the end of 2007, the Commission had committed 100% of the ISPA funds set aside for Croatia covering the period 2005 to 2007 with the commitments distributed in a balanced manner between the environment and transport sectors.

**Table 2: Projects approved in Croatia in 2005-2007 – in Euro**

Sector	Project decisions n°	Eligible cost	ISPA contribution	Average grant rate %	Commitments
Environment	3	46,287,701	29,466,355	63.65	29,466,355
Transport	2	76,502,738	29,271,310	38.26	29,271,310
Horizontal TA	1	262,335	262,335	100	262,335
<b>Total</b>	<b>6</b>	<b>123,052,774</b>	<b>59,000,000</b>	<b>47.94</b>	<b>59,000,000</b>

#### 4. PAYMENTS

Generally, payments for each project consist of two advance payments totalling 20% of the ISPA contribution, as well of intermediate payments (i.e. reimbursements) of up to 90% of the contribution, as well as a final 10% payment after closure. For the ISPA projects approved in Croatia, almost no payments were made in 2007. Just €124,629, representing 0.21% of the corresponding ISPA grants, was paid out.

Slow progress was made in 2007 in implementing ISPA measures. This was reflected by the lack of requests received for second advance and intermediate payments. Consequently by the end of the period 2005-2007, a total of €6,195,706 had been paid out, representing 10.5% of the budgetary commitments implemented in that period (€59 million).

**Table 3: Payments – in Euro**

<b>Sector</b>	<b>2005-2006</b>	<b>2007</b>	<b>Total 2005-2007</b>
Environment	3,043,266	0	3,043,266
Transport	2,975,344	0	2,975,344
TA	52,467	124,629	177,096
<b>Total</b>	<b>6,071,077</b>	<b>124,629</b>	<b>6,195,706</b>

## 5. SUMMARY TABLES

Table 4 presented below provides an overview of the ISPA interventions for the year 2007 and for the period 2005-2007.

**Table 4: Projects decided in Croatia in 2005-2007 – in Euro**

Sub-sector	N° of projects	Eligible cost	ISPA contribution	2007		2005 – 2007	
				Commitments	Payments	Commitments	Payments
Environment							
Water and sewerage	0	0	0	0	0	0	0
Water and wastewater incl. treatment	1	36,000,000	22,500,000	0	0	22,500,000	2,250,000
Wastewater treatment plant	0	0	0	0	0	0	0
Solid waste	1	8,823,601	6,000,049	0	0	6,000,049	600,005
Air quality	0	0	0	0	0	0	0
Horizontal	1	1,464,100	966,306	0	0	966,306	193,261
Sector total	3	46,287,701	29,466,355	0	0	29,466,355	3,043,266
Transport							
Road	0	0	0	0	0	0	0
Rail	1	75,761,000	28,789,180	0	0	28,789,180	2,878,918
Road and rail	0	0	0	0	0	0	0
Inland waterways	0	0	0	0	0	0	0
Airports	0	0	0	0	0	0	0
Horizontal	1	741,738	482,130	0	0	482,130	96,426
Sector total	2	76,502,738	29,271,310	0	0	29,271,310	2,975,344
Horizontal							
TA	1	262,335	262,335	0	124,629	262,335	177,096
TOTAL	6	123,052,774	59,000,000	0	124,629	59,000,000	6,195,706

## Technical assistance

### 6. FORMS AND DELIVERY OF TECHNICAL ASSISTANCE

The recourse to technical assistance measures constitutes an essential element for ensuring the successful programming and implementation of ISPA projects. These measures focus on project preparation, project implementation, accompanying institutional strengthening, and, more recently, on the structural (re)organisation of certain utilities, thereby enhancing the sustainability of project implementation. In addition, by assisting in institutional strengthening and the enhancement of administrative capacity, ISPA contributes to the preparation of the beneficiary countries for implementing the instruments of cohesion policy, in particular the Cohesion Fund.

Two types of TA activities can be distinguished:

- technical assistance which is carried out on the initiative of the beneficiary country and which is mostly directly related to project funding, i.e. project identification/preparation, extended decentralisation (EDIS) and enhancing administrative capacity;
- technical assistance which is carried out on the initiative of the Commission and which is mostly let via framework contracts. This assistance is directed mainly to the appraisal, supervision and monitoring of projects.

For the activities of the first category, the ceilings for the ISPA contribution are usually those applicable to project funding, but may in certain cases be as much as 100%. However, the costs of the activities of the second category are always entirely borne by ISPA, but the aggregate cost of them may not exceed 2% of the total ISPA allocation to the beneficiary country.

Since the beginning of ISPA, technical assistance activities on the initiative or on behalf of the Commission have been concentrated on enhancing the beneficiary countries' capacity to prepare, appraise and implement ISPA projects in accordance with the standards required for the management of Community funds, as well as for to allow the EC Delegation to perform its ex-ante control functions (intra- and extra muros staff). From the beginning of 2007 all new technical assistance measures of this type will be financed from IPA.

### 7. TECHNICAL ASSISTANCE ON THE INITIATIVE OF THE BENEFICIARY COUNTRY

#### *Project preparation and institutional strengthening*

TA measures for project preparation have to ensure that, in terms of project concept, management and operation, beneficiary countries present technically and financially sound projects to the Commission for ISPA funding. Where required, these measures can include the elaboration of strategic studies concerning the (sub-) sectors eligible for ISPA funding. Moreover, they are aimed at developing a pipeline of quality projects which is a warrant for the Commission that it identifies and receives a



sufficient number of suitable projects in time. Disposing of a strong project pipeline will be essential for the successful implementation of IPA. Two of the 3 TA measures being currently implemented are aimed at preparing IPA project pipelines in the environment and transportation sectors. The third measure is aimed at developing the institutional capacity of the CFCU to manage and implement the ISPA projects.

The total number of TA measures for project preparation approved since 2005 stands at 2, representing a total eligible cost of €2,205,838 of which €1,448,436 (65.6%) was financed by ISPA. The total number of TA measures for institutional capacity building approved since 2005 is 1, representing a total eligible cost of €262,335 which is 100% financed by ISPA.

**Table 5: Technical assistance measures on the initiative of Croatia  
2005-2007 – in Euro**

Sub-sector	No of projects	Eligible cost	ISPA contribution	Commitments 2007	Payments 2007	Commitments 2005-7	Payments 2005-7
<b>Environment</b>							
Sector total	1	1,464,100	966,306	0	0	966,306	193,261
<b>Transport</b>							
Sector total	1	741,738	482,130	0	0	482,130	96,426
<b>Horizontal TA</b>							
Sector Total	1	262,335	262,335	0	124,629	262,335	177,096
<b>TOTAL</b>	<b>3</b>	<b>2,468,173</b>	<b>1,710,771</b>	<b>0</b>	<b>124,629</b>	<b>1,710,771</b>	<b>466,783</b>

## Management and implementation

### 8. IMPLEMENTATION

The first two ISPA projects in Croatia were approved in December 2005 with a further 4 being approved in July and September 2006. By the end of 2007 physical implementation had commenced on only one of these projects (2005HR16PPT001). Despite this some progress was made with regard to the first 2 projects approved in 2005 with 3 works tenders being announced by the end of the year. In addition the tenders for a further 5 service contracts were announced, as well those for 4 Framework Contracts. By the end of the year the 4 Framework Contracts had been signed and work on these had commenced. It should also be noted that all the tenders (2 works and 1 service) for one infrastructure project (2005HR16PPT001) had been announced by the end of 2007.

There are a number of reasons for the slow speed of project implementation in Croatia. Above all the Implementing Agency has suffered from a lack of suitably experienced staff and poor management. In addition the Agency was reorganised during the year and the new structure has not been fully staffed as yet. Further problems result from the lack of experience of the final beneficiaries in preparing and running international tenders, a lack of suitable staff and unfamiliarity with ISPA procedures. Another issue that has affected the speed of project implementation has been the excessively bureaucratic procedures established by the Croats to manage and monitor the project implementation process. The Commission on a number of occasions has suggested that these procedures be streamlined. At the moment of writing no projects are in jeopardy of not meeting the N+2 rule.<sup>1</sup>

### 9. PROJECT MONITORING

Overall monitoring and evaluation of the progress and effectiveness of the implementation is supported by regular meetings in the EC Delegation offices, monitoring reports by the implementing bodies, site visits by Commission staff and formal monitoring through the twice yearly ISPA Monitoring Committee meetings in Croatia.

Apart from exerting the Commission powers for endorsing tendering and contracting, the EC Delegation is best placed to ensure progress on the ground and liaise with national authorities and final beneficiaries on any problem that may arise.

Two ISPA Monitoring Committees were held in Croatia in 2007; in June and December respectively. The main points emerging from the meetings were the necessity to accelerate the tendering and contracting processes and to ensure that the technical assistance contracts for the preparation of future project pipelines were

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<sup>1</sup> The N+2 rule refers to the requirement that the tender for the main works or supply contract within a measure must be launched within 2 years of the signature of the corresponding Financing Memorandum. In the case of a measure exclusively consisting of service contracts N+2 relates to the signature of the main service contract within 2 years of the signature of the corresponding Financing Memorandum.

contracted out as soon as possible in order to prevent later problems with IPA fund absorption. Furthermore the Commission stressed the need to utilise as quickly as possible the ISPA funded technical assistance measures available for the provision of technical and administrative support to the implementing agency and the relevant line ministries.

Whilst slow physical implementation of the projects was acknowledged the Committee did note that a number of tenders had been launched by the end of the year and, on the basis of this, that there should be a significant increase in payments in 2008.

## **10. FINANCIAL MANAGEMENT AND CONTROL, INCLUDING *EDIS***

The principal requirements for both the financial management and control and the treatment of irregularities are governed by the provisions of the ISPA Regulation and of Annex III of the Financing Memoranda, as applicable under the regime of *ex ante* control by the Commission. These requirements are close to those applicable to the Cohesion Fund and the Structural Funds. The key elements relate to the establishment of internal financial control systems and procedures that can ensure transparent and non-discriminatory procurement procedures, the accuracy of declared expenditure, adequate internal audit capability, sufficient audit trail and appropriate treatment of irregularities.

Due to the slow progress in ISPA project implementation it was decided that no specific ISPA audits would be carried out in 2007 for Croatia. However, an advisory audit was carried out by DG Regional Policy's Control and Audit Unit on the National Fund and Implementing Agency (CFCU) in April 2007 as a follow-up to the previous ISPA DIS (Decentralised Implementation System) accreditation mission. The overall conclusions of the mission for the part relating to ISPA concerned the high turnover of staff in the CFCU, and subsequently ways to ensure staff retention as well as insufficient level of checking of documents within the CFCU prior to being submitted to the EC Delegation for endorsement.

### **DIS**

The requirement for the DIS accreditation of the ISPA Implementing Agency in Croatia, the CFCU (now transformed into the CFCA), follows the stipulations of Article 164 of the Financial Regulation. DIS accreditation was awarded by the Commission on 13 February 2006.

### **EDIS**

Until EDIS (Extended Decentralised Implementation System – requiring ex-post control only) is granted, the staff of the EC Delegation in Croatia will continue to carry out ex-ante controls and play an important role in supervising the daily management, implementation and monitoring of ISPA measures. Currently the aim is to achieve EDIS for Croatia by the end of the second half of 2009. To a large extent preparations for the move to EDIS will depend on an improvement in the function of the existing DIS structure.

## **11. RISK ASSESSMENT**

The audit strategy planned for 2007 and subsequent years was based on the results of an analysis of the state of ISPA implementation and the related objectives of the Audit Directorate of DG Regional Policy. The audit strategy sets out the objectives which are defined by the senior management of DG Regional Policy. These objectives are defined on the basis of detailed discussions with the operational directorates during which information on potential risk is shared. The audit strategy then sets out the actions to achieve the objectives, taking account of the risks identified. In general, risk is minimized by implementing this strategy. No audits were carried out in 2007 due to the limited progress in implementation.

Under the system of *ex ante* approval, priority is given to ensuring that sufficient control procedures are put in place regarding project implementation and payments. However, the management of pre-accession funds carries an inherent risk since the funds are delivered by a variety of organisations and systems. Eligibility of expenditure is determined by compliance with rules and conditions fixed at Community and national level which can lead to complexity and risk of misinterpretation. The Croatian authorities are planning to submit the application to waive ex-ante control during the second half of 2009 for ISPA projects in accordance with the provisions of Regulation 1266/1999.

## **12. EUROPEAN COURT OF AUDITORS FINDINGS**

No missions or audits were carried out in Croatia during 2007.

## **13. CO-FINANCING PARTNERS – EIB, EBRD AND KfW**

Given their expertise in project preparation and implementation, the Commission has maintained regular contact with these lending institutions, both at a horizontal level to co-ordinate policy and methodological issues related to programming and implementation, and at country level. The specialist skills of these Banks in structuring grant/loan combinations of funding, including public-private partnership arrangements, is highly useful for improving the quality of projects funded from ISPA. Nevertheless the EIB is not involved in any ISPA project in Croatia with the EBRD being the only IFI which is actively involved in an ISPA project in Croatia. One environmental project approved in 2005 is co-financed by a loan from the EBRD – the Karlovac Water and Wastewater Treatment Programme.

## **Contribution to Community policies**

### **14. PUBLIC PROCUREMENT**

From the start of ISPA, the fulfilment of legal requirements for sound, fair and transparent public procurement as enshrined in the PRAG has proved to be a major challenge. In many cases, ensuring compliance with EU procurement principles has led to delays in the implementation of ISPA projects. The Commission services - especially the EC Delegation in Zagreb - had to intervene frequently, not only to check that procedures were correctly applied but also to rectify errors, to liaise with dissatisfied bidders, and to explain to the implementing agency how the procedures concerned should be implemented. Regularly, the quality of the tender documents needed to be improved resulting in the very late announcement of tenders. The cumulative effect of these interventions was additional delays to the implementation process.

The *ex ante* approval by the Commission which governs the tendering and contracting of ISPA projects is therefore entirely justified until the conditions exist for EDIS to be granted (see above). Under the ex-ante system of approval and in line with the DIS decision for the conferral of management, only the CFCA plays the role of the contracting authority responsible for project implementation, whereas the Commission endorses each step of the procurement process. It follows that, although the Commission is not a contracting partner, it bears shared responsibility for the procedural correctness of the procurement process (without the Commission's approval, contracts concluded between beneficiaries and contractors are not valid).

### **15. COMPETITION POLICY**

As the ISPA assistance is directed primarily to cover public expenditure -or equivalent - concerning utility projects, this does not generally raise problems of incompatibility with the Community rules on competition. Unless the rules on public procurement are infringed, and provided free access to such infrastructure is guaranteed for all operators meeting the necessary technical and legal conditions, such assistance does not confer any special advantage to specific firms.

### **16. ENVIRONMENT POLICY**

By providing direct assistance to priority projects for the environment, ISPA also contributes to the implementation of environmental policy and to the compliance with EU standards in Croatia. Experience gained through project development and implementation develops administrative capacity and accelerates sector reform in the environment sector. In particular, administrative capacity is being strengthened with regard to environmental investment planning and prioritisation. Continued and increased efforts are needed concerning the implementation of EIA-related legislation, especially relating to public consultation aspects. It is hoped that ISPA will in these ways contribute towards progress in environmental protection in Croatia. Problems exist in relation to the difficulties of environmental authorities in obtaining adequate funding and staffing with the high turnover of staff cancelling out of any benefits received through training and gained experience.

In this respect, it is important to emphasise that, as far as Croatia is concerned, in view of the introduction of IPA, with its greater number of bodies and a stream of additional projects, the provision of sufficient financial and human resources for implementation (including monitoring, inspection, the provision of permits and reporting) needs to be ensured.

## **17. TRANSPORT POLICY**

The transport networks in Croatia, agreed in accordance with TINA (Transport Infrastructure Needs Assessment) and REBIS (Regional Balkans Infrastructure Study) were constructed around the framework of pan-European corridors. Several of them run across the territory of Croatia including Corridors VII (the Danube river), X (Salzburg-Ljubljana-Zagreb-Beograd-Nis-Skopje-Veles-Thessaloniki, including branch Xa) as well as Corridor V, which has two branches in Croatia (Vb - Budapest, Zagreb Rijeka, and Vc - Budapest, Sarajevo, Ploče). These networks were used as the planning basis for the national transport strategies for ISPA purposes. As a consequence the single ISPA transport project forms part of the TINA and REBIS networks, i.e. it concerns the construction or rehabilitation of a section, nodal point or access relating to the networks. The TEN-T networks for Croatia are based on SEETO (South East Europe Transport Observatory) recommendations.

## **Co-ordination among pre-accession instruments**

As required by the Coordination Regulation<sup>2</sup>, the Commission ensures close co-ordination among the three pre-accession instruments, PHARE, SAPARD and ISPA. In line with the provisions of this Regulation, the PHARE Management Committee plays a special role in general co-ordination of the three pre-accession instruments.

### *Co-ordination with the (PHARE) Joint Monitoring Committee*

The Joint Monitoring Committee is responsible for co-ordinating the monitoring of each pre-accession instrument and for assessing the overall progress of EU-funded assistance in the beneficiary countries. The Committee issues recommendations to the ISPA Committee or to the Commission when relevant.

### *Co-ordination with EC Delegations*

Periodic meetings were organised by the Commission services (DGs Enlargement, External Relations and Regional Policy) with the experts in the Delegations responsible for PHARE and ISPA to discuss programming and implementation issues, in particular those related to tendering and contracting.

### *Co-ordination with the IPA instrument*

In order to ensure the efficient coordination of activities and the prevention of duplication the two ISPA Monitoring Committees held in Croatia in 2007 were organised alongside the IPA Sectoral Monitoring Committees for the Regional Development component. In addition it should be noted that 2 of the technical assistance measures being funded through ISPA relate to the preparation of project pipelines for implementation using IPA co-finance. In this way it is hoped that there will be a smooth transition from the ISPA to the IPA instruments and the uninterrupted implementation of measures in the respective sectors.

## **18. PUBLICITY ACTIONS**

No publicity actions were taken in 2007 with regard to the ISPA projects as no project had reached the physical implementation stage. However, a signing ceremony is planned to be held for the signature of the first works contract (concerning the project: Vinkovci to Tovarnik Railway Rehabilitation) in 2008. The relevant media will be invited to attend.

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<sup>2</sup> Council Regulation (EC) N° 1266/1999 of 21 June 1999 on co-ordinating aid to the applicant countries in the framework of the pre-accession strategy.